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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

In the Matter of)	
)	
Access Charge Reform)	CC Docket No. 96-262
)	
Price Cap Performance Review)	CC Docket No. 94-1
for Local Exchange Carriers)	
)	
Transport Rate Structure)	CC Docket No. 91-213
and Pricing)	
)	
Usage of the Public Switched)	CC Docket No. 96-263
Network by Information Service)	
and Internet Service Providers)	

REPLY COMMENTS OF AT&T CORP.

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SUMMARY

AT&T demonstrated in its Comments that removal of the existing enhanced service provider ("ESP") exemption is fundamental to the Commission's statutory mandates to reform interstate access charges and implement competition in the local exchange and exchange access markets. In order to achieve meaningful access reform and establish an economically rational predicate for the entry of competitive local exchange carriers ("LECs"), monopoly LECs must set their access charges at actual (TELRIC) cost and assess such cost-based charges on all users of access. AT&T's (and others') Comments also confirm that the ESP industry has achieved enviable growth in the years during which the access charge exemption has been in effect, and it is now capable of sustaining the modest increases in cost that elimination of the exemption would entail.

Although the incumbent LECs apparently support imposition of "cost-based" access charges on ESPs, they do not support TELRIC prices, and thus in effect urge the Commission to impose "market-based" access charges on ESPs. This proposal -- premised on extension of above-cost access charges to all access customers -- is entirely unacceptable for the reasons explained by AT&T (and others) in detail in the access reform proceeding. On the other hand, the ESPs oppose imposition of any access charges on them, and urge the Commission instead to ensure competitive local entry as the means to spur the deployment of new, packet-based services that would more efficiently meet their needs. However, while their support of vigorous enforcement of the local entry rules is most welcome, the ESPs ignore the fact that opening the doors to competition does not

guarantee that competitors will enter, as long as the competitive market is inhabited by incumbent carriers that provide access services at below-cost rates.

The Comments thus confirm that maintaining the status quo will stifle, rather than advance, the Commission's statutory goals. Although discussed from different perspectives, the marketplace distortions described by each of the commenting parties illustrate the economic harms that irrational pricing of a monopoly input has created. In particular, under the existing access charge regime the incumbent LECs have failed to deploy the new high-bandwidth services that the ESPs demand; the public switched local network is being used inefficiently and has the potential of becoming significantly congested; traffic is being migrated to Internet and other services that do not contribute to legitimate access cost recovery or universal service fund support; and all market participants are receiving inappropriate pricing signals that will discourage rational business decisions for years to come.

These diverse Comments underscore that the only way for the Commission to further its goals of "facilitat[ing] the development of the high-bandwidth data networks of the future, while preserving efficient incentives for investment and innovation in the underlying network" is to assess cost-based access charges on all access customers. At bottom, the ESPs' long-term interest in reasonably priced packet-switched local access services, and the interests of the incumbent LECs and their potential competitors in fair pricing of existing access services are convergent, and can be achieved by adoption of a rational, fair pricing scheme for monopoly access services. The record in this NOI thus compels the institution of a Notice of Proposed Rulemaking to assess TELRIC-based access charges on ESPs.

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REPLY COMMENTS OF AT&T CORP.

Pursuant to the Commission's December 24, 1996 Notice of Inquiry ("NOI")¹ and its subsequent January 24, 1997 Order,² AT&T Corp. ("AT&T") hereby submits these Reply Comments concerning usage of the public switched network by information service and Internet service providers.³

¹ Usage of the Public Switched Network by Information Service and Internet Service Providers, CC Docket No. 96-263, Notice of Proposed Rulemaking, Third Report and Order and Notice of Inquiry (released December 24, 1996).

² Usage of the Public Switched Network by Information Service and Internet Service Providers, CC Docket No. 96-263, Order (released January 24, 1997).

³ A list of commenters, along with the abbreviations of their names used in these Reply Comments, appears in Appendix A.

INTRODUCTION

The Comments filed in this proceeding present the Commission with what has now become a false choice between two important goals -- facilitating the development of a robust information services industry and establishing cost-based and nondiscriminatory pricing of monopoly exchange access services. The Commission has grappled in the past with this question by creating and maintaining an exemption, for one class of users of the public switched local network -- enhanced services providers ("ESPs") -- from payment of access charges, which were initially set well above cost and laden with subsidies.⁴ Today, however, as AT&T showed in its Comments, any tension between these two goals can be resolved by requiring all users of interstate access services to pay cost-based access charges.

Indeed, the favored regulatory treatment of ESPs has contributed to the growth and development of an active information services industry, with over 1,500 ESPs in the U.S. market today, many of which are well-established, well-funded companies. As AT&T's Comments showed in detail, this is an industry that can well afford to pay cost-based access charges.⁵ However, especially in recent years, the existing uneven access

⁴ MTS and WATS Market Structure, Memorandum Report and Order, 97 F.C.C. 2d 682, 715 (1983) ("MTS Market Structure Order"); MTS and WATS-Related and Other Amendments of Part 69 of the Commission's Rules, CC Docket No. 86-1, Second Report and Order, 60 Rad. Reg. 2d 1542 (rel. Aug. 26, 1986); Amendments of Part 69 of the Commission's Rules Relating to the Creation of Access Charge Subelements for Open Network Architecture and Policy and Rules Concerning Rates for Dominant Carriers, CC Docket Nos. 89-79 and 87-313, Report and Order and Order on Further Reconsideration and Supplemental Notice of Proposed Rulemaking, 6 FCC Rcd 4524 (1991) ("ONA Order").

⁵ AT&T at 10-12. See also Bell Atlantic at 4; GTE at 29.

charge treatment has created severe economic distortions, in the form of inefficient utilization of the circuit-switched local network and inappropriate investment decisions. In addition, as the technology has developed to provide "traditional" telephony services, such as voice and fax, over the Internet, the service offerings of interexchange carriers ("IXCs") and ESPs have converged, and the significant pricing disparity occasioned by the payment of vastly overpriced access charges by IXCs, on the one hand, and the ESPs' relief from payment of local network charges, on the other hand, has fueled a large -- and growing -- migration of traffic from the IXCs' services (which contribute to local network cost recovery and universal service fund ("USF") support) to the services of the ESPs (which contribute to neither).

The instant NOI reflects the Commission's attention to these critical issues; indeed, as an outgrowth of the access charge reform docket the Commission is clearly mindful that the underpinning of this proceeding is adoption of TELRIC-based local network charges for all users of access. As to the specific focus of this proceeding, however, which is not only to preserve the viability of the public switched network but also to encourage the development of needed new packet-switched technologies, unfortunately, the majority of the Comments are strikingly similar to those filed with the Commission in similar contexts over the past fourteen years. The incumbent local exchange carriers ("ILECs") recommend the imposition of "reformed" access charges on ESPs, even as they argue that such reform should be limited to setting "market-based"

charges, which do not translate to cost-based (TELRIC) rates.⁶ The ESP community, on the other hand, presses for continuation of the exemption, to ensure the continued viability of the enhanced services industry.⁷ Avoiding any discussion of the declining health of the public switched network -- and dismissing any notion of network congestion as BOC "rhetoric" to increase revenues⁸ -- the ESPs insist that the costs of their usage of the existing networks that exceed the prices that they currently pay continue to be borne by IXC's,⁹ through end user revenues from second phone lines,¹⁰ or by requiring the ILECs themselves to absorb those costs¹¹ -- in effect recommending that all other industry participants pay for their use of the local network.

Two critical changes have occurred since the last time that the Commission examined the implications of the ESP exemption which render these two static positions obsolete -- passage of the 1996 Telecom Act with its statutory mandate of competition in the local exchange and exchange access markets; and initiation of the access charge and USF reform proceedings. The Commission has recognized that the statutory imperative to open the monopoly local markets to competitive providers requires nondiscriminatory and

⁶ See, e.g., Bell Atlantic at 2, 13; GTE at 27-28; PacTel at 6; SWBT at 3; US West at 28-29.

⁷ See, e.g., IAC at 57; IUC at 10-12; Juno at 6-8.

⁸ IAC at 3.

⁹ See, e.g., id. at 57; IUC at 15; USIPA at 15.

¹⁰ IAC at 7-8 (citing ETI Study appended to IAC at 24-25).

¹¹ See IUC at 15.

cost-based pricing of access by the incumbent monopoly providers. Otherwise, the appropriate economic foundation will not be established to provide incentives for competitive providers to develop networks that compete with the existing networks of the ILECs and that offer desired new services.¹² In order to accomplish this goal, the Commission has likewise acknowledged the critical importance of achieving its long-standing objective of reforming the current subsidy-laden access charge structure, and has committed to complying with what is now its statutory obligation to remove implicit subsidies from access charges and create a new environment of explicit subsidies to support the Commission's and Congress' goal of maintaining universal service (and doing so in a focused and competitively-neutral manner).¹³

Achievement of these objectives is simply not possible when implicit subsidies to one class of user are maintained. As AT&T demonstrated in its Comments, continuation of such subsidies -- and the concomitant pricing of non-cost-based charges to ESPs -- provides disincentives to ILECs to maintain their existing networks to meet the needs of these users, discourages the development of alternative technologies by incumbent carriers (because they are unable to implement competitive prices for their existing services, and thus ESPs have no financial incentive to utilize the new

¹² Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers, Transport Rate Structure and Pricing, Usage of the Public Switched Network by Information Service and Internet Access Providers, CC Docket Nos. 96-262, 94-1, 91-213, 96-263, Notice of Proposed Rulemaking, Third Report and Order, and Notice of Inquiry, FCC 96-488 (rel. Dec. 24, 1996), ¶¶5-13.

¹³ Id. at ¶36-40; 47 U.S.C. § 254.

technologies), and dissuades competitive access providers from investing in these new networks, because they are understandably reluctant to risk such investments when existing ILEC services are offered on a subsidized basis to their targeted customers.

The unwanted behaviors described above -- logical reactions to the existing access charge pricing structure -- are reflected in the Comments of the ILECs and their potential competitors.¹⁴ On the other hand, the ESPs argue that it is the imposition of today's subsidy-laden access charges on ESPs that will discourage ILECs from deploying new data services (because, according to these ESPs, the ILECs will then realize adequate compensation for ESP usage of the existing circuit-switched network).¹⁵ The ESPs support instead vigorous implementation of the competitive local entry rules, pursuant to which competitive local exchange carriers ("CLECs") will have nondiscriminatory access to unbundled access elements at cost-based rates, meaningful collocation opportunities and equal access and interconnection.¹⁶

AT&T agrees with the ESPs that strenuous enforcement of the local entry rules is a necessary and critical predicate to competitive provision of local exchange and exchange access services by CLECs, and welcomes the ESPs' strong support for zealous enforcement of ILEC compliance with the Local Competition Order. However, this is only half of the solution. The remaining prerequisite to meaningful competitive entry into

¹⁴ See, e.g., AT&T at 8; Bell Atlantic at 12-13; MCI at 3-6; PacTel at 35.

¹⁵ See, e.g., AOL at 8.

¹⁶ See, e.g., IAC at 2-4; CompuServe at 9-10; USIPA at 18-21. See also WorldCom at 21 n. 35.

the local markets for both circuit-switched and new packet-switched local services is the cost-based pricing of the existing services offered by the ILECs to all users of the ILECs' local networks. Without rational pricing of, and nondiscriminatory assessment of charges for, those services, regardless of the fair application of the local entry rules, the CLECs will lack the incentive to introduce competitive offerings.

The Commission has before it ample evidence that the status quo is affirmatively preventing achievement of its policy and statutory goals. First, under the current scheme, there is little actual deployment of new high-bandwidth services such as ISDN, even though the technology has been available for years. Second, network congestion is becoming a concern, and may cause significant problems for users of the public switched network in the future if incentives continue to be lacking for redirection of packet traffic off of that network. Third, ESPs are continuing to invest heavily in infrastructure (such as modems) to be utilized with the existing local network, further entrenching them as ILEC customers, and creating economic disincentives for them to migrate to new packet networks as they become available.

AT&T has proposed a realistic, practical alternative which will send the appropriate signals to all players in the market, and thus mitigate each of the harms that are being encouraged under the current regime. The single most important step that the Commission can take for the advancement of its goals is to mandate the pricing of ILECs' monopoly services -- the last bastion of non-market-based pricing in the industry -- at cost, and to ensure that all users of those services pay their fair share of those costs. But even if the Commission does not immediately require, in the access charge reform docket,

TELRIC pricing for IXC's, it can and should require the assessment of TELRIC-based charges on ESP's during the transition to cost-based charges to all users. During this historic period of transformation in the telecommunications industry, the Commission must not turn its back on this most fundamental element of achieving competitive goals -- one that was embraced by the Commission over fourteen years ago¹⁷ and is now a matter of statutory mandate.

I. THE COMMENTS UNDERSCORE THE IMPORTANCE OF RATIONAL, COST-BASED ACCESS CHARGES TO ACHIEVE THE COMMISSION'S GOALS OF FACILITATING THE DEVELOPMENT OF HIGH BANDWIDTH NETWORKS AND PRESERVING INCENTIVES TO INVEST IN THE EXISTING VOICE NETWORK.

The Comments confirm that rational access pricing will not only encourage the ILECs to maintain their networks and build new services,¹⁸ but will also offer the additional benefit of providing the proper incentive to prospective CLECs to develop and deploy their own competitive services, because they will then be competing against services that are priced fairly at their actual cost.¹⁹ However, the ILECs undercut their sound economic arguments by raising overstated claims of "network congestion" and resulting "unanticipated" expenses,²⁰ while at the same time failing to use their billions of

¹⁷ See MTS Market Structure Order, 97 F.C.C. 2d 682 (1983).

¹⁸ See PacTel at 16; US West at 26.

¹⁹ See AT&T at 8; MCI at 4.

²⁰ See, e.g., Bell Atlantic at 4-9; GTE at 20-22; PacTel at 27-33; SNET at 12-19.

dollars in existing monopoly profits to alleviate these self-proclaimed network problems.²¹

It is therefore not surprising that the ESPs view with great skepticism the ILECs' claims that they need additional revenues from ESPs to perform the maintenance and upgrades occasioned by high packet-based usage of their networks.²²

The first and most important step that the Commission can take to address this concern is to reduce access charges to TELRIC and to assess such truly "reformed" charges on all users of the network, including ESPs. The benefits of such action are numerous. First, it will eliminate the disincentives of the ILECs to perform the necessary upgrades to accommodate the increased ESP traffic on their local networks. Second, it will encourage more efficient usage of the local network by ESPs and their customers, and thus deter any future, more serious threat of "network congestion."²³ Third, it will send the proper pricing signals to CLECs to make rational business decisions to enter the local

²¹ See MCI at 6 ("The lack of competition in the local market has enabled monopoly LECs to avoid optimal design of their networks").

²² See, e.g., IAC at 8; Pa.ISP at 11-14. Indeed, the Commission has before it ample evidence that the ILECs have undertaken significant planned investment to position themselves strategically in the market for advanced and broadband digital services. See Comments of AT&T Corp., CC Docket No. 96-262, filed January 29, 1997, Appendix B (Kravtin/Selwyn study); Reply Comments of AT&T Corp., CC Docket No. 96-262, filed February 14, 1997, Appendix B). See also MCI at 18 ("the amount of overbuilt plant and excess capacity belies BOC claims of congestion problems"); WorldCom at 19 n. 34 (citing a presentation of the CEO of Bell Atlantic in which he remarked that even though sales of second lines surged by more than 50 percent, Bell Atlantic generated substantial profit from those lines because "we were able to provision new lines and services from idle capacity in an existing plant").

²³ See, e.g., Bell Atlantic at 12; PacTel at 16; US West at 6-7.

market with competing services.²⁴ Fourth, it will create a sound cost basis for the pricing of IXC and ESP services, and thus stem any artificially induced migration of voice and fax traffic to the Internet, retaining traffic on the public switched network for USF contribution.²⁵

Moreover, the Commission has the authority to ensure that such access reform be achieved without increasing access revenues to the ILECs, which is a major concern not only of the ESPs, but also of the ILECs' potential competitors.²⁶ To the extent that access charges remain above TELRIC levels for the IXCs, a revenue-neutral restructure can be accomplished by reinitializing the ILECs' price caps, which would have the effect of lowering access charges to the IXCs to make up for the additional revenue collected by the LECs from the ESPs.²⁷

²⁴ See AT&T at 8; PacTel at 14-15.

²⁵ The ESPs have been relatively silent in their claims that they are "end users" and thus should not be subject to "carrier" access charges -- a mantra that has been prevalent in prior pleadings on this issue. But see IUC at 27-28; Juno at 8-10; WorldCom at 12-13. This argument, of course, is not only factually inaccurate -- AT&T and others have convincingly demonstrated that ESPs behave more like IXCs than like business customers, see, e.g., ACTA at 4-5; AT&T at 28-30; Bell Atlantic at 14-15; CompTel at 3; SWBT at 6; US West at 5, 16-17 -- it is also irrelevant, because the Commission's policy goal and objective is not to assess access charges on "carriers," but on all "users of access." ONA Order, 6 FCC Rcd 4524, 4534 (1991); see also Amendments of Part 69 of the Commission's Rules Relating to Enhanced Service Providers, Notice of Proposed Rulemaking, CC Docket No. 87-215, 2 FCC Rcd 4305 (1987) ("ESP NPRM"); MTS Market Structure Order, 97 F.C.C. 2d 682, 711, 715 (1983).

²⁶ AT&T at 25-26; MCI at 3.

²⁷ As MCI (at 6) confirms, however, if the ILECs charge all users TELRIC-based prices, there would be no double-recovery of costs by the ILECs.

The Comments also universally confirm that there is no need for the Commission to pick and choose among new technologies. The ILECs described in detail in their Comments a vast array of new services that they are preparing to bring to market,²⁸ and the ESPs have also described the many new packet services and facilities that may provide more efficient and cost-effective services for their particular needs.²⁹ Equipment manufacturers have also specified in their Comments new solutions to carry high-bandwidth data traffic more efficiently.³⁰ There is simply no basis -- nor does the Commission have the prescience or the expertise -- to select specific technologies, facilities, or services for preferences in their development and deployment. Any such selection would be entirely arbitrary. Rather, the potential customers of those new services -- the ESPs -- overwhelmingly urge the Commission to enforce the local competition rules to enable CLECs to provide new services.³¹ Such action, along with cost-based pricing of the existing local services, will assure the development of new, desired services without the need for pervasive regulatory controls.

Although many of the LEC commenters extol the new technologies that they are bringing to market, their track record in deploying new data-friendly technologies

²⁸ See, e.g., Bell Atlantic at Attachment E; BellSouth at 4-6; PacTel at 36-38; SNET at 19-23.

²⁹ See, e.g., AOL at 17-23; CompuServe at 14; IAC at 17-22. See also AT&T at 19-21; MCI at 22.

³⁰ See, e.g., DSC at 3-7; Motorola at 5-9; Nortel at 10-11.

³¹ See, e.g., IAC at 2-4; IUC at 8-9; CompuServe at 9-10; Pa.ISP at 14-15. See also MCI at 10.

has been dismal.³² And the ESPs are understandably reluctant to subscribe to these new services if doing so would require them to turn their customer lists over to their ILEC competitors,³³ or abandon their own modems and rely instead on ILEC network-based modem pools.³⁴ For these reasons, encouragement of competitive providers is the best market-based incentive to ensure that ESPs have a choice of providers for new services, and that such services are brought to market more quickly and at competitive prices.

The Commission should not, however, heed the requests of some ILECs that propose increased pricing flexibility for new services.³⁵ The Commission already has in place a framework for the provision of new services by monopoly local carriers that guards against cross-subsidization from the carrier's other services. As long as the ILECs maintain monopoly control over the local exchange, there is no basis whatsoever to retreat

³² For example, IAC (at 23-25) describes the 20-year delay in implementation of ISDN for residential customers, which is still not available on a ubiquitous basis. Moreover, it is subject to cumbersome ordering processes and is expensive. Thus, IAC concludes (at 38) that "in the absence of meaningful competition in the data services market, the ILECs have either ignored, sporadically deployed, or overpriced these technologies despite years of steadily increasing consumer demand for faster, more efficient data services." See also USIPA at 12.

³³ See Pa.ISP at 5 (Bell Atlantic's Internet Protocol Routing Service "requires an independent ISP to turn over its customer lists and customer passwords to the LEC, at the same time that the LEC has an affiliate that is competing with the independent ISPs").

³⁴ See AOL at 41 ("by deploying modem concentrators and packet-based trunk connectors in each central office, the ILECs' packet network links may indeed promote faster and more efficient delivery of broadband services, but they could also cement the ILECs as data transmission gatekeepers") (citation omitted); see also CIX at 14.

³⁵ See, e.g., PacTel at 7; SWBT at 3.

from the rules that ensure reasonable and nondiscriminatory rates for access services, not only for the benefit of their access customers, but also to maintain a pro-competitive market for emerging CLECs. Moreover, the ILECs are readily capable of successfully introducing new services and technologies under the existing rules. In December 1995, AT&T calculated that the LECs had introduced over 400 new services in the three years in which the price cap rules had been in effect as of that date.³⁶ In the intervening period, the LECs have continued to introduce new services under the existing price cap rules, including new SONET and frame relay services. Clearly there is no basis for the Commission to depart from those rules in the context of the instant NOI, and the Commission should not include such a proposal in its NPRM in this proceeding.³⁷

The economic harms occasioned by the existence of the access charge exemption have become more acute for yet another reason: the convergence of services using both circuit-switched and packet-switched technologies has enabled customers to migrate their traditional telephony services to packet-based services offered at prices significantly lower than IXCs' offerings, which must be priced to recover today's exorbitant access charges. This circumstance is leading to increasing migration of traffic not off of the local public switched network, but off of the IXCs' networks. Thus, even as

³⁶ Price Cap Performance Review for Local Exchange Carriers, CC Docket No. 94-1, Comments of AT&T Corp., filed December 11, 1995, pp. 22-26.

³⁷ BellSouth (at 6-7) proposes that the Commission amend its Computer Inquiry rules to enable it to provide a new data service as a "basic" service, despite the existence of protocol conversion in the service. This request should be examined in the context of a petition for waiver, and has no place in the instant proceeding.

traffic increases over the local ILEC networks, compensation for the costs of such traffic is declining, reducing revenues not only for legitimate cost recovery, but also for universal service fund support. The Comments reflect the concern that artificially induced migration of traffic from the public switched local network to the Internet will create even more upward pressure on access (and toll) charges and will shrink the contribution base for universal service support.³⁸ Bell Atlantic (at 9) predicts that "at their present growth rates, Internet minutes could overtake IXC minutes in just a few years." PacTel (at 10) forecasts that by the year 2001, Internet traffic will overtake residential voice traffic.³⁹ Unless these minutes are eligible for access charge payments, the establishment of "have-not" users of high-priced PSN services and "have" users of lower priced Internet offerings will be inevitable.⁴⁰ It will also force the issue of the proper scope of USF contribution.⁴¹

In this regard, the Comments confirm that, as ESP traffic volumes have increased, the ESP industry itself is now mature, with large companies that are

³⁸ See ACTA at 5-7; AT&T at 23-24; TRA at 14-18.

³⁹ See also USTA at 15-20.

⁴⁰ See CompTel at 4 ("[i]n the NOI (at ¶ 285), the Commission noted that some ILECs have predicted that Internet traffic could represent 25-30% of all local exchange traffic within three years. The Commission cannot keep such a huge traffic stream out of the access charge system without completely undermining the economic efficiency of that system").

⁴¹ Although they did not address the implications to customers of the decline in the contribution base for USF support, GTE (at 2) and PacTel (at 20-21) incredibly suggest that the ILECs receive USF support for the "shortfalls in LEC cost recovery" resulting from the ESP exemption. Of course, such a maneuver would only exacerbate the inefficiencies of the current system that encourages ESPs to use facilities without bearing their fair share of the cost.

well-positioned economically to pay cost-based prices for the access services that they use.⁴² Moreover, while the Internet Service Provider ("ISP") industry is still in a high growth and more volatile stage, the establishment of large players such as AOL, CompuServe and Prodigy, and the entry of IXC's and RBOCs into the market, belie claims that the industry is too fragile to sustain the modest average increases in price that imposition of cost-based access charges may create.⁴³ Consequently, when faced with the possibility of a modest average increase in monthly Internet charges resulting from TELRIC- based access charges⁴⁴ or a massive artificially induced migration of telephony/fax minutes from the public switched network that would otherwise contribute to USF support, the Commission's choice should be clear.⁴⁵

⁴² AT&T at 10-12; Bell Atlantic at 4; GTE at 29.

⁴³ AT&T (at 26-27) calculated a 56 cent average increase in consumers' monthly Internet access prices if the increased costs to ESPs were reflected in consumer rates, based on data provided by CompuServe. PacTel (at 6) estimated that 80 percent of end users would be impacted by less than \$5.00 per month, assuming that a charge of one cent per minute were assessed on ESPs (which is more than twice the TELRIC rate used in AT&T's analysis). PacTel provides no basis for its calculation. Even applying PacTel's one cent per minute rate to the actual data provided by CompuServe, that would increase AT&T's estimate to approximately \$1.20 per month for an average customer. Such small increases, moreover, would affect only heavier Internet users.

⁴⁴ It is far from clear that the ISPs would realize an overall cost increase as a result of the imposition of cost-based access charges. The ISP industry has responded to the current skewed pricing regime by building inefficient networks, consisting of multiple "local" points of presence ("POPs") around the country, instead of more efficient regional POPs. The deployment of such regional POPs would lower their network costs.

⁴⁵ There is much discussion about whether second phone lines to the home generate additional revenue for the ILECs to cover the increased costs to the network of ESP traffic. The ILECs claim that they do not receive excess revenues from subscription

(footnote continued on following page)

The Commission has the tools to redirect this course now, with imposition of TELRIC charges on ESPs.⁴⁶ Indeed, with the massive investment currently being made by ESPs to support their service over the existing ILEC networks,⁴⁷ such action must be taken as quickly as possible, so that ESPs do not continue to tether themselves to the circuit-switched network via these large financial commitments, and thus make their migration to packet networks less economically feasible.

(footnote continued from previous page)

to these second lines, because those lines do not generate the toll traffic and demand for vertical services that contribute to their cost recovery. See, e.g., GTE at 24-25; PacTel at 30-33; SWBT at 11. ESPs, on the other hand, argue that the sale of second phone lines generates revenues well in excess of their cost. See, e.g., IAC at 8 (citing to its ETI Study at 25-26); WorldCom at 19 n. 34. Adding to the confusion, it is far from clear that second phone lines are being used exclusively for Internet access, and no data have been provided to support that conclusion. Second (and third) lines have become increasingly common in recent years, for use by children in the home, telecommuters and other home businesses. There is no reason to believe that even if subscription to additional lines is increasing for Internet applications, those lines are not also being used for these more traditional purposes, and thus generating revenues for vertical and toll services. In any event, as with all other network components, the price for second phone lines should be set to recover their cost and should be charged to the end user, who is the cost causer. Second phone revenues should not be used to subsidize ESP usage of the local public switched network to access the Internet.

⁴⁶ AT&T suggested (at 24-25) that even if the Commission declines to adopt TELRIC charges for IXCs in the access reform docket, it can and should assess TELRIC charges on ESPs as an interim step until all access charges are brought down to cost. PacTel (at 7, 17) endorses this proposal, by recommending that ESPs may be exempt from the subsidy elements of access charges; i.e., the CCLC and TIC.

⁴⁷ See, e.g., AOL at 9, n. 11; CIX at 14.

II. THE COMMENTS CONFIRM THAT THE COMMISSION HAS AMPLE
AUTHORITY TO CLASSIFY TRAFFIC GENERATED BY ESPs AS
INTERSTATE TRAFFIC SUBJECT TO THE COMMISSION'S
JURISDICTION.

In its Comments (at 28-33), AT&T demonstrated not only that the services provided by ESPs are overwhelmingly interstate in nature, but also that to the extent that there is intrastate communication, it is for the most part inseverable and indistinguishable from the interstate traffic that is generated by the customer. On this basis, such service is properly considered interstate. AT&T further showed that sound policy considerations justify the exercise of federal jurisdiction over all ESP traffic, in order to achieve the important policy and statutory goals discussed above.⁴⁸ No commenter disputes that the vast majority of enhanced communications provided by ESPs is interstate, the most prevalent use being Internet communications.⁴⁹ IAC confirms that during a single "session," a transmission can travel to multiple and, in most cases, interstate, destinations.⁵⁰ Indeed, the Commission itself recognized the predominantly interstate

⁴⁸ AT&T also noted (at 33) that to the extent that a particular enhanced service is completely (or almost completely) intrastate in character (such as certain voice mail services), the ESP could properly purchase intrastate or local access services upon such a showing.

⁴⁹ See, e.g., GTE at 31-32; US West at 7-8.

⁵⁰ IAC at 7 n. 10 ("During the course of a single on-line session, a subscriber may obtain data from servers in multiple locations within the ESP's network or the Internet. For example, on the Internet, hypertext navigation is used to provide users with links to related information contained in other servers. By clicking on a hypertext link, a user can jump from one server to another server in a different location").

nature of ESP traffic as early as 1983, when it adopted the current access charge regime -- well before the advent of the worldwide Internet as a commercial network.⁵¹

Finally, any concerns on the part of the Commission that charging users for access to their Internet offerings amounts to forbidden "regulation of the Internet" should be alleviated upon review of the Comments. Although members of the public, in isolated comments, assert that any charges imposed on Internet providers is contrary to public policy, none of the ESPs has seriously suggested that requiring them to pay for the local services that they use constitutes "regulation" of the rates, terms and conditions of their end user offerings. Indeed, no commenter has advocated that ESPs not pay for the switches, buildings, power, employees, or other infrastructure that they utilize in providing their Internet access services; to continue to exempt them from paying for use of the local network is no different than excusing them from paying for these other inputs.⁵²

⁵¹ MTS Market Structure Order, 97 F.C.C. 2d 682, 715 (1983) ("[o]ther users who employ exchange service for jurisdictionally interstate communications, including . . . enhanced service providers, . . ."); see also ESP NPRM, 2 FCC Rcd 4305, 4306 (1987) ("Enhanced service providers, like facilities-based interexchange carriers and resellers, use the local network to provide interstate services. To the extent that they are exempt from access charges, the other users of exchange access pay a disproportionate share of the costs of the local exchange that access charges are designed to recover"); ONA Order, 6 FCC Rcd 4524, 4534 (1991).

⁵² Moreover, assessment of cost-based access charges on ESPs for their use of the local network would avoid the pitfalls of attempting to differentiate among different categories of enhanced services -- a problem on which the ESPs rely as a basis to exempt their services entirely from access charges. See, e.g., IAC at 57-59.

CONCLUSION

The Commission has before it ample and compelling evidence that the most rational and efficient means to ensure the viability of the existing public switched network while encouraging the development of new competitive packet-switched services is to implement the cost-based pricing of the local network and to assess those cost-based prices on all users of the network, including the fastest-growing segment of that user group -- the ESPs. This long overdue access reform -- coupled with zealous enforcement of the Commission's local entry rules -- will set the correct economic and regulatory framework for continued investment in both the incumbent LEC networks and in the networks of the future. The Commission can no longer extend the status quo under the guise of protecting an infant industry; rather, for the long-term benefit of that industry, the preservation of the public switched network for those that rely on it, and the achievement of universal service, the Commission must act now to remove the ESP exemption.

WHEREFORE, for the reasons stated above and in AT&T's Comments, AT&T respectfully urges the Commission to institute a Notice of Proposed Rulemaking to eliminate the exemption from Part 69 access charges for enhanced service providers, establish TELRIC pricing for those providers, and adopt a presumption that all enhanced services are interstate in nature.

Respectfully submitted,

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Bellsouth Corp. & Bellsouth Telecommunications, Inc. ("BellSouth")
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Caves, Douglas, et al.
Cincinnati Bell Telephone Company
Clark Development Company, Inc.
Commercial Internet Exchange Association ("CIX")
Competitive Telecommunications Association ("CompTel")
CompuServe Incorporated and Prodigy Services Corporation ("CompuServe")
DSC Communications Corporation
Edgewood Sr. High School Student Council
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General Services Administration ("GSA")
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